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TAGS: EFIN ECON PGOV FR
SUBJECT: FRANCE REVISES 2005 CENTRAL GOVERNMENT BUDGET

REF: Paris 7771

¶1. SUMMARY: The GOF revised its 2005 central government budget to include additional social expenditures and revised receipts including transfers to local authorities. The revised budget includes measures dear to President Chirac: a tax on airline tickets to help fund development aid, and tax cuts on future capital gains. The government offset additional expenditures, but the 2005 general government deficit probably will exceed 3.0% of GDP. END SUMMARY.

Government Commits Not to Increase Central Government Budget Deficit
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¶2. Finance Minister Thierry Breton and Budget Minister Jean-Francois Cope introduced the revised 2005 central government (CG) budget on November 23, 2005. The 2005 CG budget deficit is now set at 44.1 billion euros, an estimate the government believes is consistent with a 46.8 billion euro cash-basis deficit, which includes 2 billion euro carry-overs from 2004. In fall 2004, when the Parliament passed the 2005 appropriations bill, the deficit was set at 44.9 billion euros.

¶3. The revised 2005 budget takes into account additional spending (about 1 billion euros) for:
-An increase in already-planned expenditures (490 million euros) [particularly government guarantees (200 million euros)], compensation for victims of anti-semitic acts (134 million euros), justice fees and civil compensation (75 million euros), and government-subsidized loans (35 million euros);
-Additional social spending (300 million euros) including government housing programs (155 million euros), allowances to the handicapped (78 million euros), allowances for single parents (32 million euros), and medical assistance (27 million euros); and
-Miscellaneous spending (240 million euros), including compensation for the 2003 drought (50 million euros), public transportation (31 million euros), and official development assistance (27 million euros).

The Government Funds French CNN

¶4. Proving that the GOF still can find a place for pork-barrel projects, or perhaps reflecting its cultural diversity priorities, the government gave the green light on November 30 for an international French-language TV news channel to start broadcasting by the end of next year. The government committed to funding the channel under an agreement lasting until 2010. Thirty million euros were set aside for this project in the 2005 CG budget.

Putting a Lid on Total Spending

¶5. The government emphasized that, for the third year, the amount of the CG budget passed by the Parliament will be strictly observed. Additional spending is mostly offset by 900 million euro cuts in other parts of the CG budget, notably the public service debt (730 million euros) thanks to lower-than-projected interest rates. Total cuts (6 billion euros) offset unexpected expenditures made in February, April, September and November, notably emergency measures to prevent avian flu (1 billion euros).

¶6. Minister Breton also highlighted government efforts to control the volume of spending in 2005. He said limiting exceptions to the new rule of not carrying over more than 3% of spending would result in a significant reduction of the "carry-over bubble." He explained this would reduce the need to set aside significant reserves at the beginning of each year (7.4 billion in 2005). The government plans to reduce carry-overs from 9.7 billion euros in 2005 to around 5 billion euros in 2006, a big improvement compared with the 14.1 billion euros carried over in 2002.

Cuts in Spending Offset Lower-than-Expected Receipts

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¶7. As part of the 6 billion euro cut in CG spending, a 3.1 billion euro cut in CG spending was made in November to offset a reduction of approximately 2 billion euros in tax receipts. CG income tax receipts were expected to be lower due to sluggish economic growth. GDP growth is likely to be no higher than 1.5% in 2005, much lower than the initial government forecast of 2.5% (ref).

¶8. Government transfers to local authorities (departments) will total 510 million euros, including 457 million euros in tax on petroleum products, to pay for new local-level social responsibilities, notably for granting minimum wages (Revenu Minimum d'Insertion - RMI; and Revenu Minimum d'Activite RMA). The government claims the 510 million euro transfer will be offset by higher receipts from the exceptional levy on distributed profits due to the reform of the tax credit (250 million euros) and the revised schedule of corporate tax payments (300 million euros).

Budget Reflects Chirac's commitment to "International Solidarity" and . . .
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¶9. As part of the revised 2005 CG budget, the government approved President Chirac's plan to levy a new tax on airline tickets sold in France, in order to raise funds for development programs in developing countries, notably the fight against AIDS. The tax, which should go into effect in July 2006, will raise around 200 million euros per year by taxing tickets by 1 to 40 euros. Although President Chirac has stressed that the tax would not harm the competitiveness of the French airline industry, Christian Blanc, center-right deputy and former Air France Chairman, has criticized the tax as "a very bad idea." The French air travel industry has warned that the tax would result in a drop in passenger numbers of one million per year, including a 600,000 passenger drop in domestic flights, which could translate into 3,000 job losses. Jean-Cyril Spinetta, chief executive of Air France-KLM, said it was not the right approach, but it would not jeopardize the company's earnings targets.

. . . Increased Individual Shareholding

¶10. To encourage investment in stocks and thereby increase corporate investment, the GOF introduced measures to lower the capital gains tax. Shareholders will be partially exempted from the 16% tax on capital gains on shares bought in 2006 if they hold the shares until 2012. They will be fully exempted if they hold the shares for eight years, or until 2014. Nonetheless, shareholders will still have to pay the "social contributions" due on capital gains (11% in 2005). CEOs of small and medium-sized companies (SMEs), who decide to resign and cash in their shares, would benefit from full exemption as soon as January 2006. The government expects the sale of 50,000 to 70,000 companies each year in the next five years, and is proposing to extend the scheme of tax exemption to gains on the sales of farms and retail trade businesses.

Tax Deductions to Improve France's "Attractiveness" . . .
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¶11. The revised 2005 budget also includes measures to improve France's attractiveness (literally) by creating a 50% tax deduction on taxable profits for young artists, up to 50,000 euros per year, from the sale of works of art. The budget also seeks to improve the tax climate for senior executives who move to France by exempting transfer bonuses and some income from taxes. In a special effort to boost exports, French citizens working more than 120 days abroad and who boost French exports will benefit from full exemption of income tax, effective January 1, 2006.

. . . and to Help Sectors Affected by Oil Price Increases
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¶12. Companies harmed by oil price increases because they use trucks and buses will benefit from a reduction in certain taxes. The reduction is increased if companies use non-polluting vehicles. Partial repayment of tax on petroleum products to farmers consuming diesel fuel could be extended in 2005, on the basis of purchases of diesel made after September 1, 2005.

Other Tax schemes

¶13. The revised 2005 budget also includes increased funding for anti-fraud and anti-tax evasion activities, an increase in the general taxes on pollution in various forms, and a cut in corporate income taxes by large companies.

¶14. Deputies examined the revised CG budget from December 1 to December 8, and proposed 133 amendments. The deputies insisted that the television ("redevance") tax surplus be earmarked and dedicated to investment in the audiovisual sector for antipiracy initiatives (among others), and not to the CG budget. And it was the deputies who added the provisions increasing income tax credits to favor French

expatriates promoting French exports. Senators will start discussing the revised 2005 budget on December 19.

Budget Deficit Likely to exceed 3% of GDP in 2005

¶15. In discussing the budget, Minister Breton reiterated, "The budget deficit will be 3% of GDP." However, the general government (GG) deficit is still heavily dependent on the social security deficit. (The GG budget includes central government, social security and local authorities). Based on the Social Security Commission's estimates, the social security deficit (including health insurance, family allowances, work-related accidents and pensions) may increase to 15.2 billion euros in 2005 from 12.2 billion in
¶2004. Despite transfers from the government, local authorities fear they will be unable to balance their budgets due to required additional social spending (similar to "unfunded mandates" for state governments in the U.S.).

¶16. Citing "internal Finance Ministry sources" on September 30, the French newspaper Le Monde reported that the finance ministry privately calculated the 2005 GG deficit at 3.3-3.4% of GDP. Le Monde said that current trends for 2006 pointed to even wider deficits in the 3.5-3.6% range. In its recent semi-annual outlook, the OECD and the European Commission both forecast a general government deficit of 3.2% of GDP in 2005.

Comment

¶17. Although Breton had indicated advance knowledge of the contents of a government-commissioned report released December 14 on the ballooning general government debt (septel), the final 2005 central government budget appears to lack any coherent strategy for addressing the debt or the deficit. Although the report only called for a five-year plan to seriously control spending growth, there is little sign in this budget that the GOF feels compelled to take the politically sensitive decisions needed to implement such a plan.
STAPLETON